Inland Revenue
Te Tari Taake

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QUESTION WE'VE BEEN ASKED

QB 17/10
Income tax and fringe benefit tax – Insurance – Group insurance policy taken out by employer for the benefit of an employee

This Question We've Been Asked (QWBA) considers the income tax and fringe benefit tax treatment of group insurance policies taken out by an employer for the benefit of its employees. This insurance may be term life cover, accident/medical cover, or both. To the extent that policies contain income protection insurance, which may be included in some personal accident/medical insurance policies, they are not considered.

Key provision

ss CA 1, CX 2, CX 16, CX 37, DA 1 and DA 2 of the Income Tax Act 2007.

Key terms in this item

FBT
Fringe benefit
Insurance

Question

What is the income tax treatment of a group insurance policy that has all the following features?

- **The policy owner is the employer.**
- **The employer pays the premium.**
- **The insured persons are the employees of the employer.**
- **The employer holds the insurance policy for the benefit of the employees of the employer.**
- **The insurance is term life cover, accident/medical cover, or both.**
- **The risk insured against is the death, permanent disablement, accident, disease or sickness of the employee(s).**
- **The claim amount will either be paid to the employer by the insurer on the happening of the relevant event (death or accident or medical event), and then passed on to the relevant employee (or their estate), or paid directly to the employee at the direction of the employer.**

Answer

The employer will generally be entitled to a deduction for the premiums paid.

The premiums paid will be subject to fringe benefit tax (FBT).

Amounts paid out under the group insurance policy will not be income of the employer.

Lump sums paid out on death under a term life insurance policy will not be taxable income of the employee (or the employee's estate). Amounts paid out (or that an employee is otherwise entitled to) under accident/medical cover policies will be income of the employee only if they are income under ordinary concepts (s CA 1(2)). Amounts that are not income under ordinary concepts will not be subject to tax.

Amounts that are income under ordinary concepts may be exempt income under s CW 34 if they are paid to a person because they (or another person) are incapacitated for work and the payment is not calculated according to loss of earnings.

Explanation

1. During a review of all *Public Information Bulletins* (see http://www.ird.govt.nz/technical-tax/pib-review/), two items on the income tax treatment of insurance in an employment context were identified as being out of date. The two items are "Staff insurance schemes" (*Public Information Bulletin* No 70 (December 1972): 11) and "Life and accident insurance policies" (*Public Information Bulletin* No 106 (July 1980): 2). Those PIBs covered a number of different scenarios. We have replaced the PIBs with a series of QWBAs covering common scenarios.

2. This QWBA considers group insurance policies with the features listed in the Question above. References in this QWBA to group insurance policies taken out for the benefit of employees also refer to policies taken out where the insured person is an employee's spouse, civil union partner, de facto partner, or child.

3. Term (or temporary) life insurance pays out the sum insured (as a lump sum) if the life insured dies during the term of the policy. Many different types of insurance policies could be accident/medical insurance (or could include an element of accident/medical insurance). These include medical insurance, income protection insurance, accident insurance, and trauma or critical illness policies. This QWBA does not consider policies to the extent that they provide income protection insurance. Pay outs under these insurance policies can be periodic or lump sum and can be calculated in a variety of ways. Where a policy provides multiple types of cover, it may be necessary to apportion the claim proceeds.

4. All legislative references in this item are to the Income Tax Act 2007 unless stated otherwise.

Deductibility of premiums for employer

5. A person is allowed a deduction for an amount of expenditure or loss to the extent that it is incurred by them in the course of carrying on a business for the purpose of deriving assessable (and/or excluded) income (s DA 1). Section DA 2 sets out some limitations on deductibility. For example, expenditure that is capital in nature, or expenditure incurred in deriving exempt income, is not deductible (s DA 2(1) and (3)).

6. In most cases, salary and wage costs will be deductible because they will satisfy the nexus test in s DA 1 and none of the general limitations will apply. The payment of a premium for a group insurance policy that is paid in connection with the employees' employment is a business cost just like salary or wages. Therefore, provided the costs of an employee's salary or wages are deductible, the costs of paying the insurance premiums will be too.

When amount of premium is subject to FBT

7. Under s CX 2, a "fringe benefit" is a "benefit" that is provided by an employer to an employee in connection with their employment (s CX 2(1)(a)), and is either one of the specified benefits listed in ss CX 6, CX 9, CX 10, or CX 12 to CX 16, or is an unclassified benefit under s CX 37 (s CX 2(1)(b)). Some benefits are excluded from being fringe benefits by specific provisions in subpart CX (see s CX 2(1)(c)). Therefore, it is necessary to determine whether a

"benefit", that is either a specified benefit or an unclassified benefit, arises for employees when an employer takes out a group insurance policy, and whether any of the exclusions apply.

8. Where an employer takes out a group insurance policy with the intention of holding it for the benefit of the relevant employees (or their estates) such that the employees have an enforceable right to the claim amount, the Commissioner's view is that a trust relationship will arise. The employer is the trustee, and the employer holds the group insurance policy for the employees, who are the beneficiaries. Employers commonly use group insurance policies in this way to attract and retain employees. Information about the insurance is often, but not always, made available to employees.

9. The Commissioner's view is that the provision of the group insurance policy in this situation is a "benefit" to the employees. It provides an economic advantage to the employees as it gives them benefits (coverage under the policy) to which they would otherwise not be entitled.

10. The only potentially relevant specific provision is s CX 16. Section CX 16 applies when an employer pays a "specified insurance premium" or makes a contribution to the insurance fund of a friendly society for the benefit of an employee (s CX 16(1)). "Specified insurance premium" is defined in s CX 16(3) as follows:

> *Meaning of specified insurance premium*
>
> (3) In this section, **specified insurance premium** means a premium paid for the benefit of an employee on an insurance policy to the extent to which the insurance policy is for—
>
> (a) life insurance under section EY 8 (Meaning of life insurance) on the life of the employee or their spouse, civil union partner, or de facto partner, or on their joint lives, or on the life of their child:
>
> (b) accident or medical insurance referred to in section EY 8(3) on the life of the employee or their spouse, civil union partner, or de facto partner, or on their joint lives, or on the life of their child:
>
> (c) insurance against accident, disease, or sickness, whether fatal or not, suffered by the employee, their spouse, civil union partner, or de facto partner, or their child.

11. The Commissioner considers that most group insurance policies will fit within the requirements of s CX 16(3). On this basis, the payment of the premium will be a fringe benefit under s CX 16. However, if a group insurance policy does not come within s CX 16, it will still be an unclassified benefit under s CX 37. Section CX 37 applies to benefits that an employer provides to an employee in connection with their employment that are not covered and are not excluded by a more specific provision.

12. The only potentially relevant FBT exclusion in subpart CX is s CX 31, which deals with income protection insurance. This QWBA does not consider income protection insurance. On that basis, this exclusion will not apply.

13. Therefore, provided the group insurance policy is provided in connection with an employee's employment, the provision of a group insurance policy in the situation covered by this QWBA will satisfy the requirements of s CX 2, and there will be a "fringe benefit". As a result, the employer will be liable for FBT on the premiums paid.

Income tax treatment of proceeds – employer

14. Where the employer holds the group insurance policy on trust for the employees, the relevant employee beneficiary will have an absolute entitlement to any claim proceeds, such that those proceeds will vest in the employee. As the employer does not receive the claim proceeds for the employer's benefit, those claim proceeds cannot be income of the employer.

Income tax treatment of proceeds – employee

15. Whether a payment made under an insurance policy is taxable will depend on what it is paid for. Some payments will not be income (under a specific provision or ordinary concepts) and, therefore, will not be taxable. Payments that are "income" may be either assessable or exempt income depending on the circumstances. The following discussion is intended to help decide how a payment under an insurance policy should be treated.

16. There are no specific provisions that apply to make payments under term life or accident/medical insurance policies income. Therefore, payments under these policies will be income only if they are income under ordinary concepts (s CA 1(2)).

17. Whether a payment under an insurance policy is income or not will depend on the relationship between the payer and the recipient and the purpose of the payment (*Reid v CIR* (1985) 7 NZTC 5,176). Where a payment is made to replace income which the recipient would otherwise have earned or where the purpose of the payments is to provide the recipient with amounts to meet their living expenses, the payments are likely to be income. Payments that are regular or recurring are much more likely to be income (*Reid*). However, a one-off payment may still be income (*FCT v Hyteco Hiring Pty Ltd* 92 ATC 4,694).

18. Therefore, the payments that are most likely to be income are payments that are intended to compensate an insured person for lost income (whether periodic, or lump sum) and other regular or periodic payments intended to help the insured person meet their living expenses. Other lump sum and reimbursing payments are unlikely to be income (for example, a lump sum payment made under a term life policy, or a payment reimbursing medical expenses).

19. Payments that are not "income" will not be taxable. If a payment is "income", it is necessary to consider whether it is assessable income or exempt income.

20. The relevant exemption provision is s CW 34. A payment made to a person because they (or another person) are incapacitated for work will be exempt under s CW 34 if it is a payment by a friendly society, or a payment of income made under a policy of personal sickness or accident insurance and the payment is not calculated according to loss of earnings. If the payment does not meet these criteria, it will be assessable income.

21. The Commissioner considers that it will be rare for payments received by employees under a policy of the type considered by this QWBA to be "income" but not subject to the exemption in s CW 34.

22. Payments received for a claim under an insurance policy will not be subject to FBT.

23. The following examples are included to help explain the application of the law.

Examples

Example 1 – Term life cover

Judith's employer takes out a group term life insurance policy with the lives insured being the employer's senior employees. Judith is one of the senior employees covered by the policy. The employer intends that the policy will be held for the benefit of the employees. The senior employees are informed about the existence of the policy, and their entitlements under the policy, in their "Employee Welcome Pack". There is also a page on the employer's intranet that discusses the entitlements of the senior employees under the group insurance policy.

Judith's employer is allowed a deduction for the premiums. The premiums are subject to FBT because a fringe benefit arises under s CX 16.

Judith contracts a terminal illness that is covered by the group insurance policy. Judith's employer receives a $200,000 payment under the policy, which it passes on to Judith.

The $200,000 payment is not income of the employer. The employer only receives this amount as trustee for Judith. The $200,000 is also not income for Judith. The amount is not income under ordinary concepts. It is a one-off payment. Also, it is not paid to compensate Judith for lost income.

Example 2 – Accident cover

Bill's employer takes out a group accident/medical insurance policy with the lives insured being the employer's employees. The employer intends that the policy will be held for the benefit of the employees. This is demonstrated by the fact that the policy documents indicate that it is for the benefit of the employees. In addition, the terms of the policy allow the employees to elect to have additional voluntary cover, and to transfer the cover should the employee leave their employment.

Bill's employer is allowed a deduction for the premiums. The premiums are subject to FBT because a fringe benefit arises under s CX 16.

Bill suffers an accident where he breaks his leg and has to undergo various medical procedures. Bill's employer receives a $1,000 payment, which it passes on to Bill as a reimbursement for Bill's medical expenses.

The $1,000 is not income of the employer. The employer only receives this amount as trustee for Bill. The $1,000 is also not income for Bill. The amount is not income under ordinary concepts. It is a one-off payment. Also, it is not paid to compensate Bill for lost income.

References

Subject references

FBT
Fringe benefit
Insurance

Case references

FCT v Hyteco Hiring Pty Ltd 92 ATC 4,694
Reid v CIR (1985) 7 NZTC 5,176

Legislative references

Income Tax Act 2007, ss CA 1, CW 34, CX 2, CX 9, CX 10, CX 12 - CX 16, CX 31, CX 37, DA 1, DA 2

Other references

"Life and accident insurance policies" *Public Information Bulletin* No 106 (July 1980): 2
"Staff insurance schemes" *Public Information Bulletin* No 70 (December 1972): 11